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BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF CALIFORNIA

In the Matter of the Rate Application of)
) FILE NO.: PA-2006-00006
)
ALLSTATE INSURANCE COMPANY)
and ALLSTATE INDEMNITY COMPANY,)
)
Applicants.)
_____)

PROPOSED DECISION

I. INTRODUCTION

A. Background

Allstate Insurance Company and Allstate Indemnity Company (hereinafter referred to as "Allstate") seek an overall indicated rate increase of 9.3% for Allstate's homeowners multiple-peril line of insurance.¹ The parties agree that under the maximum

¹ Allstate Post Hearing Brief, p. 3; Additional Testimony of Steven Armstrong dated January 7, 2008, p. 2; Allstate Exhibits 97-101; Reporter's Transcript of Proceedings, Vol. I, dated January 14, p. 23. Henceforth all written testimony will cite the name of the witness, the nature of the written testimony (pre-filed direct, additional direct or supplemental direct), the date the testimony was filed and the page number. Citations to exhibits will be cited as "Exhibit" and will be preceded by the name of the party sponsoring the exhibit and followed by the page number. The reporter's transcript of the evidentiary proceeding will be cited as "RT" followed by the volume and page number. Post-hearing opening briefs will be cited as "OB" and will

permitted earned premium formula stated in California Code of Regulations, title 10, section 2644.2, et seq. (hereinafter referred to as "Regulatory Formula") the indicated rate is a 30.4% decrease to Allstate's multiple-peril homeowners insurance rates.² However, pursuant to California Code of Regulations, title 10, section 2644.27, subdivisions (f)(1) through (f)(11), an insurer may apply for variances from the rate produced by the Regulatory Formula.

Allstate applied for two such variances: (i) a variance pursuant to section 2644.27 subdivisions (f) (4) (hereinafter referred to as "Variance 4") based on Allstate's investments in underserved communities; and, (ii) a variance pursuant to section 2644.27 subdivisions (f) (11) (hereinafter referred to as "Variance 11") based on Allstate's contention that the 30.4% rate decrease produced by the Regulatory Formula is confiscatory.

Following preliminary evidentiary rulings that struck most of Allstate's Variance 11 testimony and supporting exhibits, all parties stipulated to withdraw their remaining Variance 11 testimony for purposes of the evidentiary hearing while reserving Allstate's right to argue for Variance 11 on appeal. The ALJ approved the stipulation by order of January 10, 2008.³ Therefore, the only issues to be decided in this hearing are whether Allstate is entitled to Variance 4 and, if so, how much benefit Allstate should receive for its investments in underserved communities. Allstate contends that it produced sufficient evidence to prove that it qualifies for Variance 4 and is entitled to a 2% increase to its

be preceded by the name of the party and followed by the page number. Reply briefs will be cited as "RB" and will be preceded by the name of the party and followed by the page number.

² Allstate Exhibit 97; Armstrong, Additional Testimony, January 8, 2008, p. 2; ALJ Exhibit 1; RT, Vol. 1, page 69.

³ Order Approving Stipulation Regarding Testimony and Witnesses Related to Variance 11 dated January 10, 2008.

rate of return.⁴

The Foundation for Taxpayer and Consumer Rights (hereinafter referred to as "Foundation") is a nonprofit, nonpartisan public interest corporation organized to represent the interests of insurance consumers (particularly in Proposition 103 rate rollback and prior approval rate cases).⁵ Foundation contends Allstate's proposed rate increase is excessive under Insurance Code section 1861.05. Foundation further contends Allstate failed to meet its burden of showing it is entitled to Variance 4 and that a 2% adjustment in Allstate's rate of return under Variance 4 is justified.⁶

The California Department of Insurance (hereafter referred to as "CDI") contests Allstate's proposed rate change. Unlike the Foundation, CDI concedes that Allstate has made sufficient investments in underserved communities in California to qualify for Variance 4. However, CDI contends that the full amount of Allstate's Variance 4 benefit was exhausted by the Insurance Commissioner's Order Adopting the Proposed Decision in the automobile rate case entitled *In the Matter of Rate Application of Allstate Insurance Company, Allstate Indemnity Company* (File No. PA-2007-20004) (hereinafter referred to as "Auto Rate Case"). As a consequence, CDI argues that Allstate should receive no further adjustment to its rate of return under Variance 4 in this homeowners rate case.⁷

In support of its Variance 4 request, Allstate submitted documentary evidence and the testimony of its Senior Actuary, Mr. Steven Douglas Armstrong. Mr. Armstrong oversees all Allstate's actuarial and ratemaking work performed in connection with

⁴ Allstate's OB, pp. 9-17.

⁵ The Foundation has since changed its name to Consumer Watchdog.

⁶ Foundation's OB, pp. 4-25.

⁷ CDI's OB, pp. 3, 9.

private passenger automobile and homeowners insurance within Allstate's 29 state "Western Territory," and oversaw Allstate's amended rate filing in this matter.⁸ Allstate also submitted the testimony of Ms. Dee Even, a Senior Managing Director in Allstate's Investment Department whose duties include managing Allstate's Economically Targeted Portfolio, leading Allstate's Equity Investment group and supervising the collection of Allstate's investment data for the CDI's California Organized Investment Network (hereinafter referred to as "COIN").

Foundation submitted documentary evidence and the testimony of its retained expert, Mr. Allen Schwartz, President of AIS Risk Consultants, an actuarial consulting firm. Mr. Schwartz offered opinions on whether Allstate's proposed rate change was excessive pursuant to the Regulatory Formula, whether Allstate qualified for Variance 4 and whether Allstate's requested 2% increase in its rate of return under Variance 4 was reasonable.

CDI submitted documentary evidence and the testimony of Beatrice C. Tackett, a CDI rate analyst, on the results of her review of Allstate's Homeowners Rate Application filed on June 15, 2007, and on Mr. Armstrong's evidentiary hearing testimony related to the rate calculation. CDI offered no testimony on Allstate's variance requests.

B. Procedural History

Allstate filed its rate applications nos. 06-6029 and 06-6030 with CDI on September 1, 2006, (herein referred to as "Rate Application") seeking a rate increase for its homeowners multiple-peril line of insurance.⁹ On September 8, 2006, Foundation

⁸ Armstrong, Redacted Direct Testimony, filed January 14, 2008, pp. 8, 13.

⁹ Notice of Hearing filed January 3, 2007.

served its Petition For Hearing and Petition to Intervene on the Rate Application.¹⁰ The rate proceedings were tolled by agreement of all parties in November 2006.

Subsequently, CDI filed a Notice of Hearing on January 3, 2007. Chief Administrative Law Judge Marjorie A. Rasmussen (hereinafter referred to as "ALJ") conducted a scheduling conference on February 14, 2007, and granted Foundation's Petition to Intervene.¹¹ During the scheduling conference, CDI and Foundation argued that Allstate's Rate Application should be reviewed under the amended rate regulations going into effect on April 3, 2007. The ALJ ordered the parties to brief the issue and, following oral arguments held on April 10, 2007, the ALJ ruled that the rate regulations as amended effective April 3, 2007, would apply in this matter.¹²

On April 26, 2007, the ALJ held a further scheduling conference after which the ALJ issued an order setting dates for: (a) Allstate's filing an amended rate application including any variance requests in accordance with the regulations amended effective April 3, 2007; (b) completing discovery, designating witnesses, submitting a statement of issues and a joint statement of facts in July 2007; (c) filing written testimony, exhibits and pre-hearing motions in July, August and September 2007; and (d) commencing the evidentiary hearing on September 24, 2007, in San Francisco, California.¹³

Allstate's Amended Rate Application, filed on June 15, 2007, included its requests pursuant to Variances 4 and 11, and sought a rate increase of 10.6%.¹⁴ Allstate, CDI and Foundation lodged their pre-filed direct testimony, and filed timely motions to

¹⁰ Foundation's Petition for Hearing and Petition to Intervene dated September 28, 2006.

¹¹ Order Following Scheduling Conference of February 14, 2007, p. 2.

¹² Final Ruling And Order On The Applicable Regulations To Be Applied In This Matter dated April 16, 2007.

¹³ Scheduling Conference Order dated April 26, 2007.

¹⁴ Allstate Exhibit 110.

strike. On August 10, 2007, the ALJ approved the parties' stipulation extending discovery deadlines.¹⁵

Following briefing and hearings, the ALJ issued her final rulings and order on the parties' motions to strike portions of the prepared direct testimony. The ALJ conditionally struck most of Allstate's direct testimony in support of its Variance 11 request on the grounds that it was not relevant on the issue of whether Allstate would suffer deep financial hardship if the rate produced by the Regulatory Formula were approved. To create a complete record, the ALJ granted Allstate leave to file additional testimony related to Variance 11. However, the order mandated that Allstate's additional testimony on the confiscatory issue relate to the requirements of Variance 11's "end results test" referenced in *20th Century v. Garamendi*(1994) 8 Cal 4th 216, and applied to the enterprise as a whole.¹⁶

The ALJ held a further scheduling conference in September 2007. The parties agreed on a schedule to file additional and responsive testimony on Variance 11 in September and October 2007, and further motions to strike. As a result, and in keeping with the agreements of counsel, the ALJ ordered the evidentiary hearing continued to January 14, 2008.¹⁷

The parties timely filed additional and responsive testimony on Variance 11 and subsequently filed their respective motions to strike. Following a hearing on Foundation's and CDI's motions, the ALJ ruled that Allstate's additional testimony on the confiscatory issue was relitigation testimony and not relevant. The ALJ granted

¹⁵ Order Approving Stipulation Extending Discovery Deadlines, dated August 10, 2007.

¹⁶ Final Ruling And Order On The Foundation Motion To Strike Applicants' Direct Testimony and Objections to Exhibits; CDI's Motion To Strike Applicants' Pre-Filed Testimony; and Requests For Official Notice, dated August 23, 2007, pp. 6-25.

¹⁷ Order Continuing Evidentiary Hearing, dated September 20, 2007.

Foundation's and CDI's motions to strike Allstate's additional testimony and further granted Foundation's and CDI's renewed motions to strike Allstate's direct testimony that previously had been conditionally denied.¹⁸

On January 10, 2008, the ALJ issued orders approving stipulations between the parties related to testimony and witnesses on Variances 4 and 11 as a result of the ALJ's rulings on the motions to strike. Essentially, the parties agreed that Allstate could limit its witnesses on Variance 4 to Mr. Armstrong and Ms. Even and reserve its right to use Mr. Michael J. Miller, Allstate's consulting actuary, as a rebuttal witness.¹⁹ The parties withdrew all the remaining Variance 11 testimony for purposes of the evidentiary hearing, while Allstate reserved its right to argue for Variance 11 on appeal.²⁰ The parties then filed their Joint Statement of Agreed Facts and Disputed Issues and Joint Exhibit List identified as ALJ Exhibits 1 and 2 respectively.

As ordered, the evidentiary hearing commenced on January 14, 2008, and was completed on January 15, 2008. The testimony and exhibits admitted into evidence in this proceeding are identified in the parties' Further Amended Exhibit and Testimony List filed on March 13, 2008.²¹

In addition, the ALJ took official notice of the following: (i) California Organized Investment Network list of reported COIN-qualifying Investments by Insurer and year, 1997-2004²²; (ii) CDI's Post Hearing Brief filed on December 31, 2007, in the

¹⁸ Final Ruling And Order On CDI's Motion To Strike Applicants' Supplemental Testimony; and Foundations' Motion To Strike Applicants' Additional Testimony and Objections to Exhibits, dated December 18, 2007.

¹⁹ Mr. Miller is a founding member of EPIC Consulting, LLC. Mr. Miller did not testify at the hearing.

²⁰ Order Approving Stipulation Regarding Testimony And Witnesses Related To Variance 4, dated January 10, 2008; Order Approving Stipulation Regarding Testimony And Witnesses Related To Variance 11, dated January 10, 2008.

²¹ ALJ Exhibit 2.

²² Subsequently identified as Foundation Exhibit 402 and admitted into evidence.

Auto Rate Case²³; (iii) Order Adopting Proposed Decision issued March 14, 2008, and the Proposed Decision in the Auto Rate Case; (iv) transcripts of the November 5-7 evidentiary hearing in the Auto Rate Case; (v) California Organized Investment Network Insurer Detail page for Allstate Insurance Company's Property and Casualty Investments identified as Exhibit 202 in the Auto Rate Case; and, (vi) California 2006 Market Share Report showing Allstate's Market Share on page 1 contained in Exhibit 427 in the Auto Rate Case.

The parties submitted post-hearing opening and reply briefs and further requests for official notice in April 2007. After granting the requests for official notice, the ALJ closed the record on May 9, 2008.

II. LEGAL STANDARD FOR APPROVAL OF PROPOSED RATES

A. Overview Of Insurance Code § 1861.05(A): Proposition 103

The statutes enacted through Proposition 103,²⁴ an initiative supported by a majority of voters in 1988, establish the system for the prior approval of insurance rates.

Insurance Code section 1861.05 subdivision (a) provides:

No rate shall be approved or remain in effect which is excessive, inadequate, unfairly discriminatory or otherwise in violation of this chapter. In considering whether a rate is excessive, inadequate or unfairly discriminatory, no consideration shall be given to the degree of competition and the commissioner shall consider whether the rate mathematically reflects the insurance company's investment income.

The language in the first sentence "echoes similar language in the law of most states, as well as former section 1852 which it replaces." (*Calfarm Insurance Co. v.*

²³ Subsequently identified as Allstate Exhibit 108 and admitted into evidence.

²⁴ Proposition 103 is codified at Insurance Code §1861.01 *et seq.*

Deukmejian (1989) 48 Cal.3d 805 at p. 822.) However, the requirement for prior approval of rates marked a significant change in California law. The declared purpose of Proposition 103 was to regulate insurance rates by first rolling back prices to an affordable level and then to requiring justification for rate increases.²⁵ As stated by the California Supreme Court: "If nothing else is clear, this is: Proposition 103 was intended to do away with the 'open competition' system. . . ." (*20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216 at p. 300.)

Insurance Code section 1861.05 defines a range of reasonable rates between excessive and inadequate. The California Supreme Court in the *20th Century* decision commented on the 'excessive/inadequate' provision of Insurance Code section 1861.01 as follows:

We must observe that the 'excessive'/'inadequate' standard as defined in Proposition 103 is apparently 'unique' and without 'precedent'. . . The insurers argue in substance that the 'excessive'/'inadequate' standard as defined in the initiative should be interpreted in accordance with the insurance industry's or actuarial professions' understanding of its operative terms. We believe that subdivision (a) of Insurance Code section 1861.05, as quoted above, stands in the way." (*20th Century Ins. Co. v. Garamendi, supra*, 8 Cal.4th at p. 289.)

²⁵ Section 1 of Proposition 103 entitled "Findings and Declaration," states, in pertinent part: "[E]normous increases in the cost of insurance have made it both unaffordable and unavailable to millions of Californians. [¶] [T]he existing laws inadequately protect consumers and allow insurance companies to charge excessive, unjustified and arbitrary rates. [¶] Therefore, the People of California declare that insurance reform is necessary . . . [I]nsurance rates shall be maintained at fair levels by requiring insurers to justify all future increases." Section 2 of Proposition 103, entitled "Purpose," states, in pertinent part: "The purpose of this chapter is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians." . . . (Historical and Statutory Notes, 42A West's Ann. Ins. Code (1993 ed.) §1861.01, p. 649. *See also, Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805, 813.)

The “excessive/ inadequate” language of Insurance Code section 1861.05 contemplates a range of rates that are neither excessive nor inadequate, within which the insurer has discretion to choose. (See *Calfarm Ins. Co. v. Deukmejian*, *supra* 48 Cal. 3d at pp. 822-823.)

B. The Regulatory Formula: California Code Of Regulations, Title 10, Section 2641.1 Et Seq.

1. Determination Of Reasonable Rates

The Regulatory Formula contained in California Code of Regulations, title 10, section 2641.1 et seq., was adopted to implement the provisions of Proposition 103. California Code of Regulations, title 10, section 2641.1, states that “[t]he purpose of this subchapter is to establish the process and policies the Commissioner shall employ to determine whether proposed rates are excessive or inadequate.” The determination of whether rates are excessive or inadequate is made on the basis of the aggregate earned premiums the rates are expected to produce.²⁶

Foundation and CDI contend that Allstate’s proposed rate is excessive. The Regulatory Formula defines an “excessive” rate as one that is “expected to yield the reasonably efficient insurer a profit that exceeds a fair return on the investment used to provide the insurance.”²⁷ California Code of Regulations, title 10, section 2644.1, further mandates:

2644.1 Excessive or Inadequate Rates

No rate shall be approved or remain in effect that is above the maximum earned premium as defined in section 2644.2, or is below the minimum earned premium, as defined in section 2644.3. . . . If the rate or proposed rate is excessive, the Commissioner shall indicate the highest rate that would

²⁶ Cal. Code Regs., tit. 10, §2643.3.

²⁷ Cal. Code Regs., tit. 10, §2642.1.

not be excessive, which the insurer may adopt by amendment to its application . . .

Under the Regulatory Formula as amended effective April 3, 2007, the maximum permitted earned premium is calculated as follows²⁸:

$$\text{Maximum Permitted Earned Premium} = \frac{\text{Losses} + \text{ALAE} + \text{fixed expenses} - \text{projected ancillary income}}{1 - \text{variable expense factor} - \text{max. profit factor} + \text{investment income factor}}$$

The Regulatory Formula contains definitions, methodologies and selected numeric values to be applied to given lines of insurance in determining the maximum and minimum earned premium.²⁹ California Code of Regulations, title 10, section 2646.4, subdivision (c), specifically bans relitigation of the Regulatory Formula. The regulations are clear that “[w]hile companies remain free to formulate their rates under any methodology, the Commissioner’s review of those rates must use a single, consistent methodology.”³⁰ That methodology is the application of the Regulatory Formula to the data in the insurers’ rate applications.

The California Supreme Court, in *20th Century, supra*, at p. 312, upheld this relitigation ban.

. . . [t]he effect of the ‘relitigation ban’ is unobjectionable. In adjudication, the judge applies declared law; he does not entertain the question whether its underlying premises are sound. That is as it should be. Otherwise, standardless, ad hoc decision making would result. Similarly, in quasi-adjudicatory proceedings, the administrative law judge applies adopted regulations; he does not entertain the question whether their underlying premises are sound. That is also as it should be, and for the same reason.

²⁸ Cal. Code Regs., tit. 10, §2644.2.

²⁹ Cal. Code Regs., tit. 10, §2641.1 et seq.

³⁰ Cal. Code Regs., tit. 10, §2643.1; Proposed Decision, *In re American Healthcare Indemnity Company*, File No. PA02025379, July 24, 2003, p. 8; Corrected Order Adopting Proposed Decision and Designating portion of Decision as Precedential, Aug. 22, 2003, p. 1.)

2. Standard Of Review For Determining Whether An Applicant Qualifies For A Variance And The Amount Or Degree Of A Variance

The amendments to the Regulatory Formula, effective April 3, 2007, clarified the underlying components for determining maximum and minimum earned premiums. However, the amendments did not provide a methodology or guidance for determining whether and to what extent an insurer might qualify for Variance 4.

Barring explicit direction from the legislature or the Insurance Commissioner, the ALJ must apply the Regulatory Formula when determining whether Allstate's rate request is reasonable.³¹ The Insurance Commissioner has held that, when numeric values have not been promulgated for generic factors in the Regulatory Formula for a given line of insurance, "values can be selected using generally accepted actuarial principles, expert judgment and standards of reasonableness."³² By parity of reasoning, the ALJ finds that when the Regulatory Formula does not provide a numeric value or specific methodology for determining whether and to what extent a variance may be granted, the ALJ must adopt an approach that is based on generally accepted actuarial principles, expert judgment and standards of reasonableness.³³

C. Burden Of Proof

Proposition 103 specifically places the burden of proof on the applicant.

Insurance Code section 1861.05, subdivision (b), states that "the applicant shall have the

³¹ Proposed Decision, *In The Matter of the Rate Application of American Healthcare Indemnity Company*, File No. PA02025379, July 24, 2003, p. 9; Corrected Order Adopting Proposed Decision and Designating Portion of Decision as Precedential, Aug. 22, 2003, p. 1.

³² *Id.* pp. 8-9.

³³ *Jurcoane v. Superior Court* (2001) 93 Cal.App.4th 886, 894; *20th Century*, *supra*, 8 Cal.4th at p. 312; *See*, Proposed Decision, *In The Matter of the Rate Application of American Healthcare Indemnity Company*, File No. PA02025379, July 24, 2003, pp. 8-9; Corrected Order Adopting Proposed Decision and Designating Portion of Decision as Precedential, Aug. 22, 2003, p. 1.

burden of proving that the requested rate change is justified and meets the requirements of this article.” The regulations similarly mandate that the burden of proof is on the insurer/applicant. California Code of Regulations, title 10, section 2646.5, states, in pertinent part: “[T]he insurer has the burden of proving, by a preponderance of the evidence, every fact necessary to show that its rate is not excessive, inadequate, unfairly discriminatory. . . .” The Insurance Commissioner has upheld this mandate.³⁴

Thus, Allstate bears the burden of proving, by a preponderance of evidence, every fact necessary to demonstrate that its rate is not excessive. Likewise, Allstate bears the burden of proving: (i) it qualifies for Variance 4; and, (ii) a reasonable amount for the requested variance. “Furthermore, while the commissioner must approve a rate when it is within the range of reasonableness, if the insurer fails to meet its burden, expert testimony need not be offered to support a rate disapproval.”³⁵

III. ANALYSIS OF PROPOSED RATE USING THE REGULATORY FORMULA

A. Application Of The Regulatory Formula Without Variance

All parties agree, and the ALJ finds, applying the Regulatory Formula without variance to Allstate’s updated data produces a maximum permitted earned premium of \$590.42 per exposure, which is an indicated rate decrease of 30.4%.³⁶

B. Application of the Regulatory Formula With Variance 4

Allstate seeks a 2% increase to its return on equity under Variance 4 based on its

³⁴ Proposed Decision, *In The Matter of the Rate Application of American Healthcare Indemnity Company*, File No. PA02025379, July 24, 2003, pp. 8-9; Corrected Order Adopting Proposed Decision and Designating Portion of Decision as Precedential, Aug. 22, 2003, pp. 10-11.

³⁵ *Id.* at p. 11.

³⁶ Joint Statement of Agreed Facts and Disputed Issues, dated January 11, 2008, p. 2, fn. 3; ALJ Exhibit 1, pp. 1, 23; Allstate Exhibits 101 and 112; RT, Vol. II, p. 223. Allstate’s data upon which the rate calculation is based is contained within Allstate’s Exhibit 97, 99, 101 and 110, and in the Additional Testimony by Armstrong filed on January 8, 2008.

COIN-qualified investments in the amount of \$82.5 million. CDI does not dispute that Allstate qualifies for Variance 4 but contends Allstate has received its full benefit under Variance 4 in the Auto Rate Case.³⁷ Foundation challenges Allstate's entitlement to Variance 4 and contests the 2% increase Allstate seeks on its return on equity.³⁸

The ALJ finds, and the parties agree, the Regulatory Formula modified by Allstate's Variance 4 request produces a maximum permitted earned premium of \$606.49 per exposure which is an indicated rate decrease of 28.5%.³⁹

C. Applicable Law

California Code of Regulations, title 10, section 2644.27, subdivision (f)(4), provides:

(f) The following are the valid bases for requesting a variance: . . .

(4) That the insurer should be allowed a *higher* or lower *return on equity due to higher or lower financial investment in underserved communities*, as defined in section 2646.6. (Emphasis added)

1. Definition of "Higher Financial Investment In Underserved Communities"

The regulations do not define the term "higher financial investment." Nevertheless, applying the rules of statutory construction, the ALJ finds that a reasonable interpretation of the term, "higher financial investment," means investment significantly higher than the average financial investment of comparable insurers. In the context of this proceeding, higher financial investment is financial investment that significantly exceeds the average amount invested in underserved communities by other property and

³⁷ CDI's OB, pp. 3-4, 7-10.

³⁸ Foundation's OB, pp. 9-24.

³⁹ Allstate Exhibits 101, 112.

casualty insurers doing business in California.⁴⁰

As in the Auto Rate Case, Foundation and CDI contend that Allstate failed to meet its burden of proof to show that its identified investments are in underserved communities defined in California Code of Regulations, title 10, section 2646.6.⁴¹ The term, “underserved community” is defined in California Code of Regulations, title 10, section 2646.6 as follows:

“Underserved Community” means those communities which the Commissioner has determined are underserved as set forth in the “Commissioner’s Report on Underserved Communities.”⁴²

The term is further defined in California Code of Regulations, title 10, section 2646.6, subdivision (c) that states:

A community shall be deemed to be underserved by the insurance industry if the Commissioner finds:

(1)(A) the proportion of uninsured motorists is ten percentage points above the statewide average as reflected in the most recent Department of Insurance statistics regarding the statewide average of uninsured motorists; and

(B) the per capita income of the community, as measured in the most recent U.S. Census is below the fiftieth percentile for California; and

(C) the community, as measured in the most recent U.S. Census, is predominately minority. Predominately minority community can be quantified as any community that is composed of two-thirds or more minorities as those groups are defined in subsection (b)(6)(A) through (D) herein; or

⁴⁰ *Day v. City of Fontana* (2000) 25 Cal.4th 268, 272 [“if . . . the statutory terms are ambiguous, then we may resort to extrinsic sources, including the ostensible object to be achieved and the legislative history”]; *In re Player* (2007) 146 Cal.App.4th 813, 825 [holding the rules of statutory construction apply equally to statutes and regulations]; *MacIsaac v. Waste Management Collection and Recycling, Inc.* (2005) 134 Cal.App.4th 1076, 1082, 1084 [absent clear legislative history, a judge must cautiously apply “reason, practicality, and common sense to the language at hand”].

⁴¹ Foundation’s OB, pp. 10-12.

⁴² Excerpts from 2005 Commissioner’s Report on Underserved Communities for the experience year 2004 are in CDI Exhibits 333 and 334.

(2) the proportion of uninsured businesses or residences is ten percentage points above the statewide and/or Standard Metropolitan Statistical Area ("SMSA") average as determined by the Commissioner following a public hearing convened for the purpose of determining the number of uninsured businesses or residences in this state.

Allstate claims it does not track all its investments in underserved communities by zip code and bases its Variance 4 request on investments that meet the requirements for inclusion in CDI's 2005 COIN report.⁴³ However, the Regulatory Formula defines investments that qualify for Variance 4 differently from COIN-qualifying investments.⁴⁴ Under the Regulatory Formula, an investment must be located within a zip code listed in the Commissioner's Report on Underserved Communities. Zip codes included in the Commissioner's report are identified as areas having high levels of uninsured motorists, uninsured homeowners and businesses, low-income levels and high minority populations. By contrast, COIN-qualifying investments are investments in community development projects in low to moderate-income areas in California.⁴⁵

While CDI and Foundation claim that Allstate failed to prove its investments in underserved communities fall within the zip codes included in the Commissioner's report, CDI concedes that the requirements for COIN investments are similar to the requirements for investment in underserved communities in the regulation and that Allstate should be granted a reasonable variance under Variance 4:

[W]hen the requirements for COIN investments are compared with the requirements for Variance 4 Qualifying Investments, both share the concept of low-income communities and it seems reasonable to expect that there

⁴³ Even, Prepared Direct Testimony filed January 14, 2008, pp. 4-5; Even, Supplemental Testimony filed December 31, 2007, pp. 1-2; RT, Vol. I, pp. 157-158.

⁴⁴ CDI's OB, p. 3.

⁴⁵ *Ibid.*

will be significant overlap. Further, Applicants have shown that they compare favorably with other insurers by making relatively large investments in underserved communities. Finally, Allstate's witness Ms. Even testified that Allstate does not track its investments by ZIP code so Allstate relied on the COIN report. . . . For these reasons, even though Applicants have not qualified their investments perfectly under the regulation, CDI believes that they should be granted a reasonable variance for their investments in underserved communities.⁴⁶

The ALJ further notes that while California Code of Regulations, title 10, section 246.6, was last amended, effective March 15, 2003, subsequently enacted Insurance Code sections 926.1 and 926.2 (Added by Stats. 2006, c. 456 (A.B.925)) provide a more expansive statement of the public policy encouraging insurance companies to invest in underserved communities and does not mention ZIP codes as follows:

Community Development Investment” means an investment where all or a portion of the investment has as its primary purpose community development for, or that directly benefits, California low-income or moderate-income individuals, families, or communities. “Community Development Investment” includes, but is not limited to, investments in California in the following:

- (1) Affordable housing, including multifamily rental and ownership housing, for low-income or moderate-income individuals or families.
- (2) Community facilities or community services providers (including providers of education, health, or social services) directly benefiting low-income or moderate-income individuals, families or communities.
- (3) Economic development that demonstrates benefits, including, but not limited to, job creation, retention or improvement, or provision of needed capital, to low-income, or moderate-income, individuals, families, or communities, including urban or rural communities, or

⁴⁶ *Id.* at p. 4.

businesses or nonprofit community service organizations that serve these communities.

(4) Activities that revitalize or stabilize low-income or moderate-income communities.

(5) Investments in or through California Organized Investment Network (COIN)-certified Community Development Financial Institutions (CDFIs) and investments made pursuant to the requirements of federal, state, or local community development investment programs or community development investment tax incentive programs, if these investments directly benefit low-income, or moderate-income, individuals, families, and communities and are consistent with this article.

(6) Community Development Infrastructure Investments.

(7) Investments in a commercial property or properties located in low-income or moderate-income geographical areas and are consistent with this article.⁴⁷

Foundation's strict interpretation of qualifying investments for Variance 4 is not persuasive. COIN investments and those investments made in accordance with the Commissioner's Report on Underserved Communities each further the public policy of encouraging insurance companies to provide economic support for low-income communities. As a consequence, the ALJ finds that Allstate's COIN-qualifying investments in this matter satisfy the regulatory requirements for investment in underserved communities.

D. Summary Of Variance 4 Evidence

The ALJ considered the entire evidentiary record and the matters over which she took official notice in formulating this proposed decision. The salient portions of the evidence are summarized as follows:

⁴⁷ Ins. Code §926.1, subd. (b).

1. Mr. Armstrong's Testimony

As previously noted, Mr. Armstrong, Allstate's Senior Actuary, oversees all actuarial and ratemaking work that is performed in connection with Allstate's private passenger automobile and homeowners insurance within the twenty-nine states that comprise Allstate's "Western Territory".⁴⁸ Specifically, Mr. Armstrong is responsible for the actuarial methods Allstate uses to develop the underwriting profit provision Allstate uses in the ratemaking formula.⁴⁹ Mr. Armstrong offered testimony supporting Allstate's entitlement to Variance 4 and Allstate's request for a 2% increase in its rate of return under the variance, from 10.8% to 12.8%.⁵⁰

Mr. Armstrong noted that the Regulatory Formula does not provide a methodology for quantifying the amount of benefit that should be given a company once it proves entitlement to Variance 4.⁵¹ Mr. Armstrong formulated the methodology for determining the value of Allstate's Variance 4 request by first determining how much higher an investment in underserved communities needed to be in order to qualify for Variance 4.

The latest publicly available report of the California Organized Investment Network (COIN) – Qualifying Investments (Detail Report of Investments by Insurer (1997-2004)) indicates that the insurance industry has invested a total of \$8,384,950,891 in COIN-qualifying investments.⁵² Mr. Armstrong determined that Allstate had invested \$205,761,271 or 2.5% of all dollars invested by the insurance industry in underserved

⁴⁸ Armstrong, Prepared Testimony filed January 14, 2008, p. 8.

⁴⁹ *Ibid.*

⁵⁰ *Id.* at p. 52.

⁵¹ RT, Vol. I, pp. 32-33.

⁵² Allstate Exhibit 73, p. 97.

communities in California.⁵³ Using the average dollar amount invested in underserved communities as a benchmark, Mr. Armstrong concluded that any company whose investments in underserved communities were higher than the average investment would be entitled to an increase in its rate of return under Variance 4.⁵⁴

Next, Mr. Armstrong determined how to quantify the amount of the additional rate of return. He plotted on a chart the amount of investments other companies made in underserved communities and noticed that there were clusters of companies to the right of the center or average point on his chart that made similar additional investments above the norm. Thus, "using some judgment" he made the assumption that any company to the right of the average point on the chart would be able to ask for at least a one percent increase in their rate of return "because we're using round numbers in our framework."⁵⁵ Subsequently, Mr. Armstrong compared Allstate's financial investments in underserved communities with Allstate's peer group and found that Allstate's investments far exceeded the investments of the other top market share insurers. Based on this preliminary analysis, Mr. Armstrong concluded that Allstate was entitled to a 2% increase in its rate of return.⁵⁶

However, as Mr. Armstrong observed, using judgment in calculating the variance request "is all fine and good, but I wanted to be able to also include some type of hard quantification, if you will, that could support our judgment."⁵⁷ To this end, Mr. Armstrong employed a simple statistical method whereby he calculated what the standard

⁵³ Armstrong, Prepared Testimony filed January 14, 2008, pp. 51-52; Allstate Exhibit 73, pp. 1-97.

⁵⁴ RT, Vol. I, pp. 30-31.

⁵⁵ RT, Vol. I, pp. 31-32.

⁵⁶ RT, Vol. I, p. 32.

⁵⁷ RT, Vol. I, p. 33.

deviation was from the average.⁵⁸ Mr. Armstrong described the standard deviation method as follows:

Standard deviation is just simply a way of quantifying how far away something is from the average. Dispersion from the mean, as statisticians might say. For example, if you have a data set where a lot of the data points were very far away from the average, then you would have a high standard deviation.

If you have a whole bunch of data points that cluster right around a particular average, the standard deviation would be really small. If it is extreme, if all the data points were at the exact same point, . . . everybody had the average, . . . then your standard deviation would be zero.⁵⁹

By comparing Allstate's standard deviation with other top market share insurance companies, Mr. Armstrong found that Allstate was just a little over two standard deviations above the average investments for that data set.⁶⁰ This result matched Mr. Armstrong's initial judgment to request a two percent increase in Allstate's rate of return.⁶¹

In response to criticism from Foundation that Allstate included investments made by life insurance companies when calculating Allstate's percentage of COIN-qualifying investments, Mr. Armstrong further analyzed the source data from the 2005 COIN report by removing all life insurance company investments and re-calculating Allstate's percentage of underserved community investments without life insurance investment data.⁶² The analysis showed that, according to the 2005 COIN report, the total amount of COIN-qualifying investments attributable to California homeowners multi-peril

⁵⁸ *Ibid*

⁵⁹ RT, Vol. I, p. 41; Allstate Exhibit 111.

⁶⁰ *Ibid*

⁶¹ *Ibid*.

⁶² RT, Vol. I, pp. 34-35, 38-39.

companies doing business in California was \$284,720,161. Of this amount, Allstate invested \$82,504,288 and was the second highest investor in underserved communities among all other companies writing homeowners insurance in the state of California.⁶³ The highest ranked company invested \$88,012,365 and the third ranked company invested \$34,128,899.⁶⁴ Armstrong then determined the average company writing homeowners insurance in California invested 1.6% of all the COIN-qualifying investments pursuant to the 2005 COIN report. By contrast, Allstate invested 29% of all COIN-qualifying investments.⁶⁵ Using a standard deviation analysis, Mr. Armstrong concluded that Allstate was “just shy of five standard deviations away from the average of 1.6%.”⁶⁶ In Mr. Armstrong’s opinion, being five standard deviations from the mean in this analysis would support a request for an increase in the rate of return of more than 2%.

Mr. Armstrong conducted a further analysis of the data in the 2005 COIN report to respond to CDI’s position in the Auto Rate Case that only high impact COIN-qualifying investments should be considered when determining eligibility for Variance 4.⁶⁷ He noted the total amount invested by California homeowners multi-peril companies in high-impact COIN-qualifying investments was \$59,259,999. Of this total amount, Allstate’s investments ranked the highest at \$29,316,743, representing almost one half of all high-impact COIN-qualifying investments in California.⁶⁸ Mr. Armstrong further

⁶³ Allstate Exhibit 102.

⁶⁴ *Ibid.*

⁶⁵ RT, Vol. I, pp. 39-40; Allstate Exhibit 102.

⁶⁶ RT, Vol. I, p. 41; Allstate Exhibit 102.

⁶⁷ The CDI argument referenced in Mr. Armstrong’s testimony was introduced for the first time in CDI’s post hearing brief in the Auto Rate Case and ultimately rejected by the Commissioner by the Order Adopting the Proposed Decision in the Auto Rate Case. As noted, CDI offered no testimony on Variance 4 in either the Auto Rate Case or in this matter.

⁶⁸ Allstate Exhibit 103.

observed the second ranked company invested a little under \$9 million. Using the standard deviation method, Armstrong found the average company's percentage for high impact investments remained at 1.6%, while Allstate's percentage of high-impact COIN-qualifying investments equaled 49.5%, or 6.7 standard deviations away from the mean.⁶⁹

Under direct and cross-examination, Mr. Armstrong addressed various criticisms of his methodology. Responding to Foundation's claim that Allstate's 2.5% investment in underserved communities is not significant based on its 13% market share of California homeowners insurance and its 5% market share across all lines of property casualty insurance, Mr. Armstrong replied that there is no relationship between the amount of exposures Allstate writes and the amount of money Allstate invests in underserved communities.⁷⁰

In using the data from the 2005 COIN report, Mr. Armstrong admitted that he did not determine or make adjustments for Allstate's investments that may have matured or been reinvested. He also admitted that he had not calculated the current book value of these investments or determined the source of the premium dollars for any of the investments.⁷¹ Mr. Armstrong stated he used the same standard when he collected data on the investments made by Allstate and by other companies contained in his analysis, in order to be consistent. "Realistically because there is no other way that one could perform the analysis. One might be able to make feasible adjustments for Allstate, but if you can't make the same adjustments for all the other companies, your analysis kind of untangles very quickly at that point."⁷²

⁶⁹ RT, Vol. I, pp. 55-57; Allstate Exhibits 103, 113.

⁷⁰ RT, Vol. I, pp. 34, 106.

⁷¹ RT, Vol. I, pp. 101-106.

⁷² RT, Vol. I, p. 110.

Mr. Armstrong conceded that Allstate would receive an additional \$16 million in homeowners premium if it received a 2% increase in its rate of return under Variance 4. However, he took exception to mathematical underpinnings of Foundation's "end result test" that equated the additional premium to a 300% return on Allstate's investments in underserved communities. Mr. Armstrong noted that Foundation divided the \$16 million in additional premium by the average of Allstate's investments during the last three years of the COIN report instead of the entire investment period covered by the report thereby producing an inflated the percentage of return.⁷³

Mr. Armstrong conducted a stress test of Mr. Schwartz's "end result test" and calculated that Mr. Schwartz's analysis would produce only a .26% rate of return.⁷⁴ Mr. Armstrong also conducted a stress test on CDI's proposed analysis offered in the Auto Rate Case, and calculated that CDI's analysis would produce only a .0004% increase to Allstate's rate of return.⁷⁵ In each stress test, Mr. Armstrong criticized Foundation's and CDI's calculations because "the comparisons are made on an inconsistent basis, as the increase in premium that results from the increase in Rate of Return is not a return on investment." Mr. Armstrong opined that Foundation's and CDI's proposed rates of return are inconsequential, given that Allstate is the second highest investor in underserved communities according to the 2005 COIN report.⁷⁶

In summary, Mr. Armstrong concluded that: (1) Allstate is a leading investor in COIN-qualifying investments in underserved communities; (2) Allstate is always more than two standard deviations above any average in all his calculations, justifying a 2%

⁷³ RT, Vol. I, pp. 42-44.

⁷⁴ RT, Vol. I, pp. 44; Allstate Exhibits 114, 116.

⁷⁵ RT, Vol. I, pp. 42-47, 52-54; Allstate Exhibits 115, 116.

⁷⁶ RT, Vol. I, pp. 44, 54.

increase to its rate of return; (3) employing the “end test results” proffered by Foundation would equate to an inconsequential increase in the additional rate of return; and (4) CDI’s methodology set forth in its Auto Rate Case post hearing brief, as described in Allstate Exhibit 107, also would give any qualifying company inconsequential relief under Variance 4.⁷⁷

2. Ms. Even’s Testimony on Variance 4

Ms. Even is Senior Managing Director of Allstate Investments, LLC, the in-house asset manager for the Allstate Insurance Group. Ms. Even offered testimony in support of Allstate’s record of investment in underserved communities and its request for a 2% increase in its rate of return under Variance 4.

Since 1995, Ms. Even’s duties have included responsibility for strategy and business development of Allstate’s Economically Targeted Investment Portfolio (hereinafter, referred to as “Portfolio”). The investments in the Portfolio are made strictly to serve underserved communities across the nation, with the majority of investments being made in California and Illinois.⁷⁸ “These investments generally support affordable housing, health care, child care, and commercial development of disadvantaged areas.”⁷⁹ Ms. Even testified that Allstate has been a pioneer in investing in underserved communities throughout the nation and has played a key role in increasing investment in underserved communities in California.⁸⁰

Allstate’s investment strategy is formed without regard to the particular state or

⁷⁷ RT, Vol. I, pp. 62-63; Allstate Exhibit 107.

⁷⁸ RT, Vol. I, pp. 122, 125.

⁷⁹ Even, Prepared Direct Testimony filed January 14, 2008, p. 4.

⁸⁰ Even, Prepared Direct Testimony filed January 14, 2008, pp. 6-7.

region in which its premium dollars originate.⁸¹ Other than for its life insurance line, Ms. Even testified Allstate does not track its pool of investment money by premium dollars or lines of insurance. "The money flows, in essence, to our treasury department. We're given an amount of money to invest, and the actual origin of particular dollars is not identifiable. It's fungible."⁸²

Ms. Even testified that Allstate expects to receive a reasonable rate of return on the investments, but Allstate's primary purpose is to improve the economic status of underserved communities. Most of the Portfolio investments tend to have a higher risk profile than normal institutional quality investments.⁸³ Moreover, the return on these investments is below the return Allstate would achieve on investment grade corporate bonds.⁸⁴

Ms. Even testified that Allstate Insurance Company and Allstate Indemnity Company are parties to an investment management agreement with other Allstate companies. The investment management agreement determines the nature of the investments made on behalf of all parties to the agreement, and these investments benefit the entire group.⁸⁵ When asked why Allstate Indemnity receives investment benefits like Allstate Insurance Company when Allstate Indemnity has not made any investments, Ms. Even explained that Allstate Indemnity reinsures 100% of its liabilities to Allstate Insurance Company, and most of Allstate Indemnity's assets are managed in total with Allstate Insurance Company. Therefore, the investments made in the name of Allstate

⁸¹ RT, Vol. I, p. 128.

⁸² RT, Vol. I, p. 142.

⁸³ RT, Vol. I, p. 123.

⁸⁴ RT, Vol. I, pp. 200-201.

⁸⁵ RT, Vol. I, pp. 127, 165-166.

Insurance Company inure to the benefit of Allstate Indemnity.⁸⁶

Allstate also participates in COIN, a CDI program facilitating voluntary insurance industry investment in traditionally underserved communities in California. Ms. Even supervises the collection of Allstate's investment data for the COIN data call.⁸⁷ In addition to reviewing investments submitted by insurers, CDI's COIN division publishes "COIN Investment Opportunity Bulletins," identifying community development investment opportunities.⁸⁸ These investment opportunities are available through CDI's bulletin process and the COIN website to all insurers doing business in California.⁸⁹ Based on the COIN Insurer Investment Summary for 1997-2004 contained in the 2005 COIN report, insurers doing business in California have invested \$8,384,950,891 in underserved communities.⁹⁰ Allstate Insurance Group invested \$205,761,727 toward underserved and rural markets throughout California.⁹¹ Ms. Even confirmed that Allstate Insurance Group has 64 of the total 2,606 investments, or 2.5% of total investments made by the industry.⁹² Of the \$205,761,727 invested by Allstate Insurance Group, Allstate Insurance Company invested \$82.5 million.⁹³ The portfolio balance of Allstate's COIN-qualifying investments in the 2005 COIN report was 68 million as of December 31, 2004.⁹⁴

However, Ms. Even testified that approximately 75%, or approximately \$250 million of Allstate's investments in underserved communities in California were rejected.

⁸⁶ RT, Vol. I, pp. 127, 197.

⁸⁷ RT, Vol. I, p. 122; Even, Prepared Direct Testimony filed January 14, 2008, p. 3.

⁸⁸ Even, Prepared Direct Testimony filed January 14, 2008, p. 4

⁸⁹ *Id.*

⁹⁰ Even, Prepared Direct Testimony filed January 14, 2008, p. 7; Allstate Exhibit 76, p. 97.

⁹¹ Even, Prepared Direct Testimony filed January 14, 2008, p. 7; Allstate Exhibit 76, pp. 4-6.

⁹² *Ibid.*

⁹³ RT, Vol. I, pp. 191-192.

⁹⁴ RT, Vol. I, p. 132.

and not included in the 2005 COIN report. Ms. Even surmised that some of Allstate's investments were rejected because the COIN process requires matching investments to zip codes or census tract data. Except for commercial mortgages held primarily by Allstate Life Company, Allstate typically does not store its investment data by zip code.⁹⁵ Although Allstate does not track all of its bond investments by zip code, Ms. Even testified that Allstate uses its best judgment based on the purpose of the particular bond and the end use of the money to determine whether a bond investment serves an underserved community.⁹⁶

Allstate's investments in municipal bonds also were excluded from the 2005 COIN report, but Ms. Even noted that they will be included in the most recent 2007 COIN data call.⁹⁷ Ms. Even testified that the market value of Allstate's municipal holdings in underserved areas originating during the period from 1997 to 2004 represents an additional \$928,889,426 of investment beyond that reflected in the COIN report, with \$107 million of the \$928,889,426 originating in 2003 and 2004.⁹⁸ According to Ms. Even, if Allstate's municipal holdings were included in the 2005 COIN report, Allstate's investments in underserved communities would have been significantly higher than currently reflected, particularly in the last two years of that report.⁹⁹

Some of Allstate's COIN investments are identified as Impact or Impact Community Capital. Ms. Even testified that Impact Community Capital (herein after referred to as "Impact") is a limited liability corporation formed by seven insurance companies strictly for the purpose of increasing insurance investments opportunities in

⁹⁵ RT, Vol. I, p. 133.

⁹⁶ RT, Vol. I, pp. 189-190.

⁹⁷ Even, Prepared Direct Testimony filed January 14, 2008, p. 5, 8; CDI Exhibit 313; RT, Vol. I, p. 131.

⁹⁸ Even, Prepared Direct Testimony filed January 14, 2008, p. 8.

⁹⁹ *Ibid.*

California's underserved communities. Impact has since diversified its pool of loans so that about 75% of their overall investments are in California, and the balance is out of state. Ms. Even, along with representatives from State Farm and Pacific Life, originated the idea for Impact, funded the development of the corporation and recruited the other founding member companies.¹⁰⁰ Impact is the only limited liability corporation of its kind in the nation.¹⁰¹

On cross-examination, Ms. Even confirmed that, if Allstate is granted a two percent increase in its rate of return on equity under Variance 4 in this matter, the additional two percent rate of return is going to benefit all the Allstate companies that are parties to the investment management agreement.¹⁰² Ms. Even also admitted that the COIN Insurer Investment Summary for 1997-2004 indicates Allstate invested an average of approximately 5 million per year during the last three years of the 2005 COIN report.¹⁰³ However, Ms. Even denies that Allstate's investments have decreased over time because one should look at an entire portfolio rather than to amounts invested in a given year when evaluating a portfolio.¹⁰⁴ Moreover, Ms. Even contended that Allstate's investments in underserved communities are considerably higher than the amount shown on the COIN report for 2002-2004, since about \$140 million in investments were not accepted by COIN because they did not track with zip codes.

Ms. Even disagreed with Foundation's claim that Allstate had not shown it had a materially higher investment in underserved communities based on its 13% share of California homeowners insurance market and its 2.5% of the industry's total investments

¹⁰⁰ RT, Vol. I, p. 134.

¹⁰¹ RT, Vol. I, p. 136.

¹⁰² RT, Vol. I, pp. 127, 166-167.

¹⁰³ Foundation Exhibit 402-1; RT, Vol. I, p. 182.

¹⁰⁴ RT, Vol. I, pp. 129, 132.

in underserved communities. According to Ms. Even, Foundation's analysis erroneously compared market share with investment dollars.¹⁰⁵ Investment strategy, on the other hand, is formed without regard to the particular state or region in which premium dollars originate.¹⁰⁶ Ms. Even also took exception to Foundation's contention that the 2% variance Allstate is requesting is equivalent to Allstate receiving more than an additional 300% return on its investments in underserved communities. "When one rates an investment we look strictly at the return coming for that particular investment. Mr. Schwarz's analysis suggests that additional rate relief is equivalent to investment return, and they are two different concepts."¹⁰⁷

Likewise, Ms. Even disagreed with the claim that, when Allstate reinvests funds previously invested in underserved communities, it is inappropriately double counting the investment dollars (double dipping). Reinvestment of these funds increases the overall capacity of investment dollars in underserved communities, which is the goal of the program. "In fact, the best thing that can happen is for those dollars to be recycled and made available again within those communities."¹⁰⁸

Ms. Even testified that, if benefits under Variance 4 were based solely on a company's high-impact investments, as urged by the CDI, it would frustrate the intent of Variance 4. Companies might stop making medium and low impact investments, and the overall dollar amounts invested in underserved communities would likely go down since high-impact investments are more difficult to make and there are not that many

¹⁰⁵ RT, Vol. I, p. 128.

¹⁰⁶ *Ibid.*

¹⁰⁷ RT, Vol. I, pp. 138-139.

¹⁰⁸ RT, Vol. I, pp. 142-143.

available.¹⁰⁹

In summary, Ms. Even testified that Allstate is a major investor in California's underserved communities, and its Variance 4 request is reasonable.

3. Mr. Schwartz's Testimony

Mr. Schwartz is President of AIS Risk Consultant, an actuarial consulting firm started in November 1984. Mr. Schwartz is a fellow of the Casualty Actuarial Society, an Associate in the Society of Actuaries, a Member of the American Academy of Actuaries and a Fellow of the Conference of Consulting Actuaries.¹¹⁰ Mr. Schwartz offered testimony on behalf of Foundation's contention that Allstate has not shown a higher financial investment in underserved communities or justified the numerical value of the variance requested.

In support of his conclusion that Allstate has not shown a higher financial investment in underserved communities, Mr. Schwartz compared Allstate's written premium with its percentage of COIN-qualifying investments with other insurers. Mr. Schwartz's analysis indicated Allstate has a 2.5% investment in underserved communities, a 13% share of the California homeowners insurance market and about a 5% share of premiums across all lines of property casualty insurance. Thus, Allstate's market share of investments in underserved communities is below its market share of business written in California.¹¹¹

Mr. Schwartz noted that Allstate's 2.5% investment also reflects investments made by Allstate's life insurance companies, and after removing these investments from

¹⁰⁹ RT, Vol. I, pp. 139-140.

¹¹⁰ Schwartz, Prepared Direct Testimony filed January 15, 2008, pp. 3-4; Mr. Schwartz's qualifications and experience as an actuary are listed in Foundation Exhibit 401.

¹¹¹ Schwartz, Prepared Direct Testimony filed January 15, 2008, p. 12; Allstate Exhibits 76 and 77; Foundation Exhibit 403.

the total, only about 40% of what Allstate characterized as investment in underserved communities is attributable to its property casualty business.¹¹² Mr. Schwartz concluded that Allstate's investments in underserved communities represent only about 1% of the total insurance industry investments and are considerably lower than the 2.5% value shown on Allstate's Exhibit 20.¹¹³

Mr. Schwartz found Mr. Armstrong's method for evaluating the level of investment in underserved communities between insurance companies inappropriate. In Mr. Schwartz's opinion, Mr. Armstrong's comparison analysis only looked at the total dollars invested by each company. This analysis tends to give larger insurance companies an unfair advantage over smaller companies in evaluating the variance because larger companies have more dollars to invest than smaller companies. However, as a proportion of their total business, smaller companies could have a significant percent invested in the COIN areas, but Allstate's methodology will not reflect this percentage.¹¹⁴ Mr. Schwartz offered an alternative approach that took into account the total dollars of investment between companies in relation to the size of the company. This method considers the total dollars each company writes because it is the premium dollars that insurance companies use to operate and make investments. Based on this analysis, shown in Foundation Exhibit 416, Allstate is only about one quarter of a standard deviation from the mean as compared with the two-plus deviations shown in Allstate's Exhibit 111.¹¹⁵

On Foundation Exhibit 416, Mr. Schwartz purportedly listed all property casualty insurance companies doing business in California that had invested in COIN-qualifying

¹¹² Schwartz, Prepared Direct Testimony filed January 15, 2008, p. 12; Allstate Exhibit 76; Foundation Exhibit 403.

¹¹³ Schwartz, Prepared Direct Testimony filed January 15, 2008, p. 13.

¹¹⁴ RT, Vol. II, pp. 225-226.

¹¹⁵ RT, Vol. II, pp. 226-227, 235.

investments. Next, he compared each company's COIN-qualifying investment with their market share to derive a ratio of investment percent to market share for each company. Mr. Schwarz calculated that Allstate's ratio of investment percent to market share was 1.63. Accordingly, Mr. Schwartz concluded that, while Allstate has a somewhat higher investment in COIN-qualifying investments relative to the average, it was not significantly higher.¹¹⁶

In reviewing the 2005 COIN report covering the eight year period from 1997 to 2004, Mr. Schwartz concluded that Allstate's annual investment in underserved communities decreased during 2002, 2003 and 2004 by the following amounts: \$0.8 million in 2002, \$3.7 million in 2003 and \$9.5 million in 2004, resulting in an annual average of \$4.7 million during the last 3 years covered in the 2005 COIN report.¹¹⁷ Based on all of the foregoing, Mr. Schwartz concluded that Allstate has not shown that it qualifies for Variance 4.

Mr. Schwartz also testified that Allstate did not justify the numeric value of the 2% increase in rate of return it is requesting under Variance 4. According to Mr. Schwartz, an additional 2% on equity increases Allstate's annual premium level by about \$16 million. Dividing the \$16 million of additional premium by Allstate's average \$5 million annual investment in underserved communities during 2002 to 2004 produced a return of more than 300% ($\$16 \text{ million} / \$5 \text{ million} = 320\%$). The 300% return also is in addition to any return achieved from the actual investment.¹¹⁸ In Mr. Schwartz's opinion, the 2% variance is not reasonable because it is the equivalent of Allstate receiving more

¹¹⁶ RT, Vol. II, p. 236.

¹¹⁷ Schwartz, Prepared Direct Testimony filed January 15, 2008, pp. 13-15, fn. 6; Foundation Exhibit 402.

¹¹⁸ *Id.* at p. 15.

than an additional 300% return on its investments in underserved communities.¹¹⁹

Next Mr. Schwartz determined how much of Allstate's investment in COIN communities was attributable to its homeowners insurance line. According to his analysis, Mr. Schwartz concluded that 30% of Allstate's business in California is related to its homeowners line of insurance. He multiplied the \$5 million dollars in average annual investments Allstate made during the last 3 years of the 2005 COIN report by Allstate's 30% share in the California homeowners market. Based on this calculation, Mr. Schwartz testified that Allstate invested \$1.5 million dollars over the 2002-2004 periods from money attributable to its homeowners market. Mr. Schwartz concluded that the additional \$16 million in premium Allstate is requesting in connection with Variance 4 is more than ten times higher than the \$1.5 million Allstate invested in COIN communities in 2002 to 2004, a ratio of over 1,000 %.¹²⁰

Using this same calculation and applying it to the average total investments Allstate made during the entire eight year period covered by the 2005 COIN report, Mr. Schwarz determined that Allstate's average COIN investment was \$10 million a year. This would reduce Allstate's investment return from 1000% to 500%. In Mr. Schwartz's opinion, either return produced by his calculations is grossly excessive, especially since a lot of Allstate's investments are fixed income investments that typically should get a lower return than equity investments.¹²¹

Under cross-examination, Mr. Schwarz admitted that he has no prior experience in managing institutional investment portfolios, has never been an investment advisor,

¹¹⁹ *Id.* at p. 14.

¹²⁰ RT, Vol. II, pp. 236-239.

¹²¹ RT, Vol. II, pp. 239-242.

did not take finance courses in college, and his college degree was in physics.¹²²

Mr. Schwartz conceded that his analysis contained on pages 11-13 of his pre-filed testimony filed on January 15, 2008, compared the investments made by Allstate (a single property and casualty insurance company) with investments made by the entire insurance industry regardless of line. Mr. Schwartz explained that it would be impossible to do a rate analysis for every homeowners insurance company in the state when looking at a single company's rate filing.¹²³ Mr. Schwarz admitted that Foundation Exhibit 416 upon which he based the above conclusions also compared Allstate to all lines of insurance, including those not regulated by Proposition 103. In response to the ALJ's request that he redraft Foundation Exhibit 416 eliminating the insurance lines not regulated by Proposition 103, Mr. Schwartz produced Foundation Exhibit 417 without further explanation. Exhibit 417 shows that Allstate's adjusted ratio of investment percent to market share changed from 1.63 to 1.81 under Mr. Schwartz's same analysis.¹²⁴

Under cross-examination, Mr. Schwartz testified that a company could make higher than average investments in underserved communities but not be entitled to any benefits under Variance 4.¹²⁵ He admitted he does not know of any homeowners insurance company that writes business in California that would be entitled to Variance 4 under his analysis.¹²⁶ Later, on re-direct examination, Mr. Schwartz explained that, since the Regulatory Formula does not specify how to determine whether a company qualifies for Variance 4, different points of view can be taken. One point of view is that any

¹²² RT, Vol. II, pp. 261-263.

¹²³ RT, Vol. II, pp. 264-267.

¹²⁴ Foundation Exhibit 417.

¹²⁵ RT, Vol. II, p. 245.

¹²⁶ RT, Vol. II, p. 268.

company that is above average in investments would qualify for the variance. Another point of view is that a company that has significantly invested over the mean amount qualifies.

Mr. Schwartz agreed that the Regulatory Formula does not contain language that an insurer's entitlement to Variance 4 is dependent upon the insurer's investment in underserved communities increasing every year. Furthermore, while Mr. Schwartz's analysis suggests that Allstate should segregate its investments in underserved communities by line of insurance, he is not aware of any multi-line property and casualty insurer that writes business in California that does so.¹²⁷

While Mr. Schwartz attributed 30% of Allstate's \$82.5 million in COIN-qualifying investments to premium derived from Allstate's 30% market share, he admitted that capital and surplus also are sources of "investable" assets. When asked during cross-examination, Mr. Schwartz could not recall what proportion of Allstate's invested assets was derived from capital and surplus. When shown a calculation based on data from Allstate's rate filing that showed 62% of Allstate's invested assets derived from capital and surplus, he declined to accept the result, stating that he was unsure of the source of the numbers used in the calculation. He subsequently admitted that he did not know whether the majority of Allstate's invested assets were attributable to premium or derived from capital and surplus, because he had not performed any calculations to make this determination.¹²⁸

Mr. Schwartz also admitted that, in certain scenarios, a smaller company would receive a higher rate of return than a larger company for the same amount of investments

¹²⁷ RT, Vol. II, p. 273.

¹²⁸ RT, Vol. II, pp. 276-281.

in high-impact COIN-qualifying investments in underserved communities using the methodology espoused by CDI in the Auto rate case.¹²⁹ On re-direct, Mr. Schwartz stated that CDI's methodology was actuarially sound because both companies would get the same dollar amount on their identical investment despite the differences in the rate of return.¹³⁰

When Mr. Schwartz was asked whether he thought a smaller company's investment of \$10 million dollars in underserved communities would have more value than a larger company's \$82.5 million investment, Mr. Schwartz conceded that \$82 million was a larger number than \$10 million and deferred to the ALJ to determine the definition of "value" under Variance 4.¹³¹

In summary, Mr. Schwartz concluded that: (1) Allstate had not shown it has a higher investment in underserved communities; (2) Allstate had not shown its investment in underserved communities has remained consistent over time, as opposed to decreasing; and, (3) Allstate had not justified its 2% Variance 4 request.¹³²

E. Discussion

1. Allstate Met Its Burden Of Proof On Its Eligibility for Variance 4

In order for a company to establish eligibility for Variance 4, it must prove that it has a "higher . . . financial investment" in "underserved communities."¹³³ Allstate has proven by a preponderance of the evidence that its COIN-qualifying investments in underserved communities far exceed those made by other property-casualty insurers doing business in California.

¹²⁹ RT, Vol. II, pp. 283-288.

¹³⁰ RT, Vol. II, pp. 319-321.

¹³¹ RT, Vol. II, pp. 291-292.

¹³² Schwartz, Prepared Direct Testimony filed January 15, 2008, p. 11.

¹³³ Cal. Code of Regs., tit. 10, §2644.27 (f)(4).

Using the data contained in the 2005 COIN report, Mr. Armstrong determined conclusively that Allstate was the second highest investor in underserved communities among all companies writing homeowners insurance in the state of California, with investments totaling \$82,504,288, or 29% of all COIN-qualifying dollar investments. Mr. Armstrong's further analysis of the data proved that Allstate ranked first in high impact COIN-qualifying investments with \$29,316,743, or 49.5% of the total amount invested in these areas. The ALJ finds Allstate's statistical evidence on this issue credible and Mr. Armstrong's analyses, in support of Allstate's eligibility for Variance 4, actuarially sound.

CDI concedes that Allstate has made sufficient investments in underserved communities in California to justify a variance under Variance 4.¹³⁴ Foundation, on the other hand, maintains that Allstate failed to meet its burden of proof regarding its entitlement to Variance 4. The evidence presented by Mr. Schwartz and the arguments offered by Foundation in support of its position are without merit.

Foundation claims Allstate used an eight-year period of COIN investments (1997-2004) even though, under California Regulations, title 10, section 2642.6, some of these investments were made outside the three-year historical period "from which data are taken to provide the basis for the proposed rate."¹³⁵ Foundation's legal premise is groundless. Variance 4 does not require investments in underserved communities to be made within the time specified in section 2642.6, and Mr. Schwarz's analysis in support of this premise carries no weight. The ALJ has found that the 2005 COIN report is the most current and reliable source for investment data regarding Variance 4, and Allstate

¹³⁴ CDI's OB, p. 3.

¹³⁵ Foundation's OB, p. 5; RT, Vol. I, pp. 117-118.

correctly relied upon the 2005 COIN report in support of its variance request.

Foundation also argues that Allstate failed to make certain adjustments to its \$82.5 million in COIN-qualifying investments to account for portions that: (1) were no longer invested in underserved communities; (2) had matured; or, (3) had been reinvested (referred to herein as “double-counting”).¹³⁶

The 2005 COIN report represents a static snapshot of investments at the time of the report, while investment experience is dynamic. Companies invest, and their investments mature and are reinvested or invested elsewhere. If Foundation demands that Allstate account for adjustments to its investment portfolio, then, in order to be credible, the same adjustments must be made for all company portfolios against which Allstate’s is being compared. Mr. Schwartz’s analysis only considered Allstate’s investment portfolio, and he based many of his conclusion only with reference to that incomplete data set. On the other hand, Mr. Armstrong’s analysis used the investment information for each company in the 2005 COIN report consistently.¹³⁷ The ALJ finds Mr. Armstrong’s approach more credible than Mr. Schwartz’s suggested methodology.

Foundation also contends that Allstate is not eligible for Variance 4 because Allstate made no attempt to allocate its COIN-qualifying investments to its homeowners line for purposes of its Variance 4 request.¹³⁸ Foundation cites no legal authority that requires investments be tied to lines of insurance, and the Regulatory Formula contains no such requirement. Foundation’s argument is without legal basis and there is strong evidence in the record that, as a practical matter, no company would be able to track its investments by line of insurance for purposes of a Variance 4 request. Ms. Even and Mr.

¹³⁶ Foundation’s OB, pp. 5-6; RT, Vol. I, pp. 74-76, 101-102, 132, 193, 195-196..

¹³⁷ RT, Vol. I, p. 102.

¹³⁸ Allstate Exhibits 102, 103; RT, Vol. I, pp. 36, 77.

Armstrong confirmed that Allstate does not track its pool of investment money by premium dollars or lines of insurance.¹³⁹ The two halves of the investment transaction are separated: money from premium and other revenue sources flows into Allstate's treasury, and investments flow out of the treasury. Indeed, Mr. Schwartz admitted on cross-examination that he was not aware of any multi-line property and casualty insurer writing business in California that tracks their investments by line of insurance.¹⁴⁰ Accordingly, the Foundation's argument is without merit.

Foundation claims that Allstate Indemnity Company made none of the claimed investments, yet it seeks the same variance as Allstate Insurance Company.¹⁴¹ The ALJ finds that the record supports Allstate Indemnity's Variance 4 request. Allstate Insurance Company and Allstate Indemnity are parties to an investment agreement with other Allstate companies, and investments are made on behalf of and for the general benefit of all the parties to the agreement. Allstate Indemnity cedes 100% of its liabilities to Allstate Insurance Company as reinsurer, and most of Allstate Indemnity's assets are managed jointly with Allstate Insurance Company. Thus, investments made in the name of Allstate Insurance Company inure to the benefit of Allstate Indemnity.¹⁴²

Foundation's final contention regarding Allstate's eligibility for Variance 4 is based on the claim that Allstate made no adjustment to account for the size of its market share when comparing itself to other companies.¹⁴³ According to Mr. Schwartz, premium dollars translate into market share, and based on this premise, Mr. Schwartz concluded that Allstate's share of investments in underserved communities was below its market

¹³⁹ RT, Vol. I, pp. 102-103, 142; Allstate Exhibits 102, 103.

¹⁴⁰ RT, Vol. II, p. 273.

¹⁴¹ Schwartz, Prepared Direct Testimony filed January 15, 2008, p. 12; Allstate Exhibit 76; RT, Vol. I, p. 77.

¹⁴² RT, Vol. I, p. 128.

¹⁴³ Foundation's RB, p. 8.

share of business written in California.¹⁴⁴ Mr. Schwartz claims that Allstate's methodology for determining its entitlement to Variance 4, without an adjustment for market share, would unfairly advantage larger companies over smaller companies.¹⁴⁵ Based on the record, the ALJ finds that no relationship exists between the amount of exposures Allstate writes and the amount it invests in underserved communities.¹⁴⁶ Furthermore, Mr. Armstrong's eligibility analysis showed that Allstate's COIN-qualifying investments were higher than those investments made by the subset of Allstate's top market share competitors.¹⁴⁷ Accordingly, the ALJ finds that Foundation's arguments and evidence in support of market share and investment comparisons have no legal foundation and are unpersuasive.

Based on the foregoing discussion and the record in this matter, the ALJ finds Allstate used an actuarially sound method for proving it made significantly higher investments in underserved communities in California than other companies during the period covered in the 2005 COIN report.

In conclusion, the ALJ finds that Allstate proved its eligibility for Variance 4 by a preponderance of the evidence.

2. Allstate Met Its Burden Of Proof On The Amount Of Its Variance 4 Request

Allstate requests that its rate of return on equity be increased by 2% under Variance 4, from 10.8% to 12.8%.¹⁴⁸ CDI and Foundation contend that Allstate should

¹⁴⁴ Schwartz, Prepared Direct Testimony filed January 15, 2008, pp. 11-12.

¹⁴⁵ RT, Vol. II., pp. 225-226.

¹⁴⁶ RT, Vol. I, p. 106.

¹⁴⁷ RT, Vol. I., p. 32.

¹⁴⁸ Armstrong, Prepared Testimony filed January 14, 2008, p. 52.

not be granted any adjustment to its rate of return under Variance 4 in this matter.¹⁴⁹

Since the Regulatory Formula provides no guidance or methodology for determining the amount of variance a qualifying company will receive for investing in underserved communities, the parties asked the ALJ to take official notice of the Commissioner's Order Adopting the Proposed Decision in the Auto Rate Case, but for different reasons. Allstate claims the Order in the Auto Rate Case supports Allstate's Variance 4 request in this matter while Foundation and CDI argue the opposite.

The evidence on the quantification issue has been summarized above. CDI's and Foundation's contentions on the issue are summarized as follows: (1) Allstate has failed to meet its burden to demonstrate that its requested 2% is a reasonable amount by which to increase its rate of return on equity; (2) Allstate must not be allowed to receive duplicate benefits in both its private passenger auto and homeowners insurance lines; (3) Allstate should, at most, be allowed a 3% additional return on its high impact COIN-qualifying investments for all of Allstate's combined lines; (4) Allstate's benefit under Variance 4 was exhausted in the Auto Rate Case.¹⁵⁰

Allstate counters that: (1) Mr. Armstrong's quantification methodology in support Allstate's Variance 4 request is actuarially sound; and (2) CDI's and Foundation's attempts to challenge Allstate's quantification methodology have no legal bases.¹⁵¹ Allstate's arguments are persuasive.

Allstate's request for a 2% increase in its rate of return on equity under Variance 4 is based on substantial credible evidence demonstrating Allstate's investments in underserved communities in California far exceed the amounts invested by other

¹⁴⁹ CDI OB, pp. 4-10; CDI RB, pp. 2-4; Foundation OB, pp. 9-26; Foundation RB, pp. 12-17.

¹⁵⁰ CDI OB, pp. 4-10; CDI RB, pp. 2-4; Foundation OB, pp. 9-26; Foundation RB, pp. 12-17.

¹⁵¹ Allstate OB, pp. 15-17; Allstate RB, pp. 5-21.

companies writing homeowners insurance in California. The ALJ finds Mr. Armstrong's standard deviation analyses, in quantifying the amount of Allstate's Variance 4 request, actuarially sound. By contrast, the ALJ finds Foundation's evidence deficient and not credible.

Mr. Schwartz's ratio analyses challenging Allstate's standard deviation methodology suffer the same deficiencies that undermined Mr. Schwartz's eligibility analyses; they are not supported by the record and have no basis in law.¹⁵² For example, his ratio test comparing the premium dollars each property and casualty company has to invest with the amount of their COIN-qualifying investments makes the unfounded assumption that every dollar in premium a company in his analysis collects is available to be invested.¹⁵³ As a result, this analysis is not credible.

Mr. Schwartz's analysis also ties increases in premium resulting from increases in the rate of return under Variance 4 to the returns received on the COIN-qualifying investments. The ALJ finds that increases in premium that result from increases in the rate of return are not a return on Allstate's investment.

CDI argues that that Variance 4 benefits should be quantified based solely on high impact COIN-qualifying investments and allocated across all lines of insurance. However, the quantification analysis proposed by CDI is not contained in the Regulatory Formula governing this matter. CDI's and Foundations' arguments primarily appear to be policy-based and highlight perceived errors or omissions in the regulations. The ALJ must apply the regulations as written and has no authority to engage in rulemaking, as

¹⁵² Allstate RB, pp. 19-20

¹⁵³ Foundation Exhibit 417.

urged to do so here.¹⁵⁴

CDI and Foundation complain that granting Allstate's request for Variance 4 will result in a premium that is excessive. This argument is not persuasive. Variance 4 as written is intended only to adjust the rate of return component of the Regulatory Formula. Once the variance is approved and applied, the Regulatory Formula produces a modified reasonable maximum and minimum permitted earned premium range.

In conclusion, the ALJ finds that Allstate proved it is entitled to a 2% increase in the rate of return under Variance 4 by a preponderance of the evidence.

IV. CONCLUSION

The ALJ finds that Allstate has proven by a preponderance of evidence that it is eligible for Variance 4 and qualifies for a 2% increase to its return on equity, pursuant to California Code of Regulations, title 10, section 2644.27, subdivision (f) (4).

Allstate concedes that there is not sufficient evidence remaining in the record after the entry of orders on the motions to strike Allstate's testimony and exhibits proffered on Variance 11.¹⁵⁵ The ALJ finds that Allstate has not proven by a preponderance of the evidence that it is entitled to Variance 11.

Based on the foregoing, the ALJ finds the Regulatory Formula modified by Allstate's Variance 4 request produces a maximum permitted earned premium of \$606.49 per exposure which is an indicated rate decrease of 28.5%. The ALJ also finds that an

¹⁵⁴ *Jurcoane v. Superior Court, supra.*, 93 Cal.App.4th 886, 894. As previously noted, the Regulatory Formula as amended in May 2008, has eliminated Variance 4: Question on whether a company should be granted an increase to its rate of return for higher investments in underserved communities will be moot.

¹⁵⁵ Final Ruling And Order On The Foundation Motion To Strike Applicants' Direct Testimony and Objections to Exhibits; CDI's Motion To Strike Applicants' Pre-Filed Testimony; and Requests For Official Notice, dated August 23, 2007; Final Ruling And Order On CDI's Motion To Strike Applicants' Supplemental Testimony; and Foundations' Motion To Strike Applicants' Additional Testimony and Objections to Exhibits, dated December 18, 2007.

indicated rate decrease of 28.5% for Allstate's homeowners multiple-peril line of insurance is reasonable.

V. FINDINGS OF FACT AND CONCLUSIONS OF LAW

1. All findings in this decision shall be considered to be either findings of fact or conclusions of law. They should be read in conjunction with the discussion above which explains the reasons for the determinations;
2. The hearing was full, fair and allowed the parties a reasonable opportunity to present relevant evidence and argument;
3. In a rate hearing, the Commissioner reviews Allstate's proposed rates and determines whether they are excessive, inadequate or unfairly discriminatory using the numeric values and methodology in the Regulatory Formula;
4. Barring explicit direction from the legislature or the Insurance Commissioner, the ALJ must apply the Regulatory Formula when determining whether Allstate's proposed rates are reasonable;
5. When the Regulatory Formula does not provide a numeric value or specific methodology for determining whether and to what extent a variance may be granted, the ALJ must adopt an approach that is based on generally accepted actuarial principles, expert judgment and standards of reasonableness;
6. Allstate bears the burden of proving that its requested rate increase will not result in excessive, inadequate or unfairly discriminatory rates as defined in the Regulatory Formula;
7. Allstate also bears the burden of proving: (i) it qualifies for Variance 4; and, (ii) a reasonable amount for the requested variance;

8. While the commissioner must approve a rate when it is within the range of reasonableness, if the insurer fails to meet its burden, expert testimony need not be offered to support a rate disapproval;
9. The Regulatory Formula without variance to Allstate's updated data produces a maximum permitted earned premium of \$590.42 per exposure; an indicated percent change of -30.4% to Allstate's multiple-peril homeowners insurance line rates;
10. The Regulatory Formula modified by Allstate's Variance 4 request produces a maximum permitted earned premium of \$606.49 per exposure; an indicated percent change of -28.5% to Allstate's multiple-peril homeowners insurance line rates;
11. A reasonable interpretation of the term "higher financial investment" in the context of the prior approval regulations are financial investments in an amount above the average amount invested in underserved communities by all other property and casualty insurers doing business in California;
12. Allstate's COIN-qualifying investments are equivalent to Variance 4 Qualifying Investments;
13. Allstate has proven by a preponderance of evidence that it is eligible for Variance 4 and qualifies for a 2% increase to its return on equity, pursuant to California Code of Regulations, title 10, section 2644.27, subdivision (f) (4);
14. Allstate has not proven by a preponderance of the evidence that it is entitled to Variance 11;

15. The Regulatory Formula modified by Allstate's 2% Variance 4 request produces a maximum permitted earned premium of \$606.49 per exposure which is an indicated rate decrease of 28.5%;

16. On this record, the indicated rate decrease of 28.5% for Allstate's homeowners multiple-peril line of insurance is reasonable.


ORDER

Based on the foregoing, IT IS ORDERED that:

1. The overall indicated rate increase of 9.3% for Allstate's homeowners multiple-peril line of insurance is rejected; and,
2. A 28.5% rate decrease for Allstate's homeowners multiple-peril line of insurance is approved and shall become effective 20 days after the adoption of this decision by the Commissioner or as soon thereafter as Applicants are able to provide the necessary documentation and implement the necessary changes with the California Department of Insurance Rate Filing Bureau.

This proposed decision is submitted on the basis of the entire record in this proceeding and I recommend its adoption as the decision of the Insurance Commissioner of the State of California.

Dated: July 3, 2008


MARJORIE A. RASMUSSEN
Chief Administrative Law Judge
Administrative Hearing Bureau